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Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

No. 632

318US #28
MCD-MYE

RUSSELL W. McDERMOTT,

vs.

Petitioner,

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT, AND BRIEF IN
SUPPORT THEREOF.**

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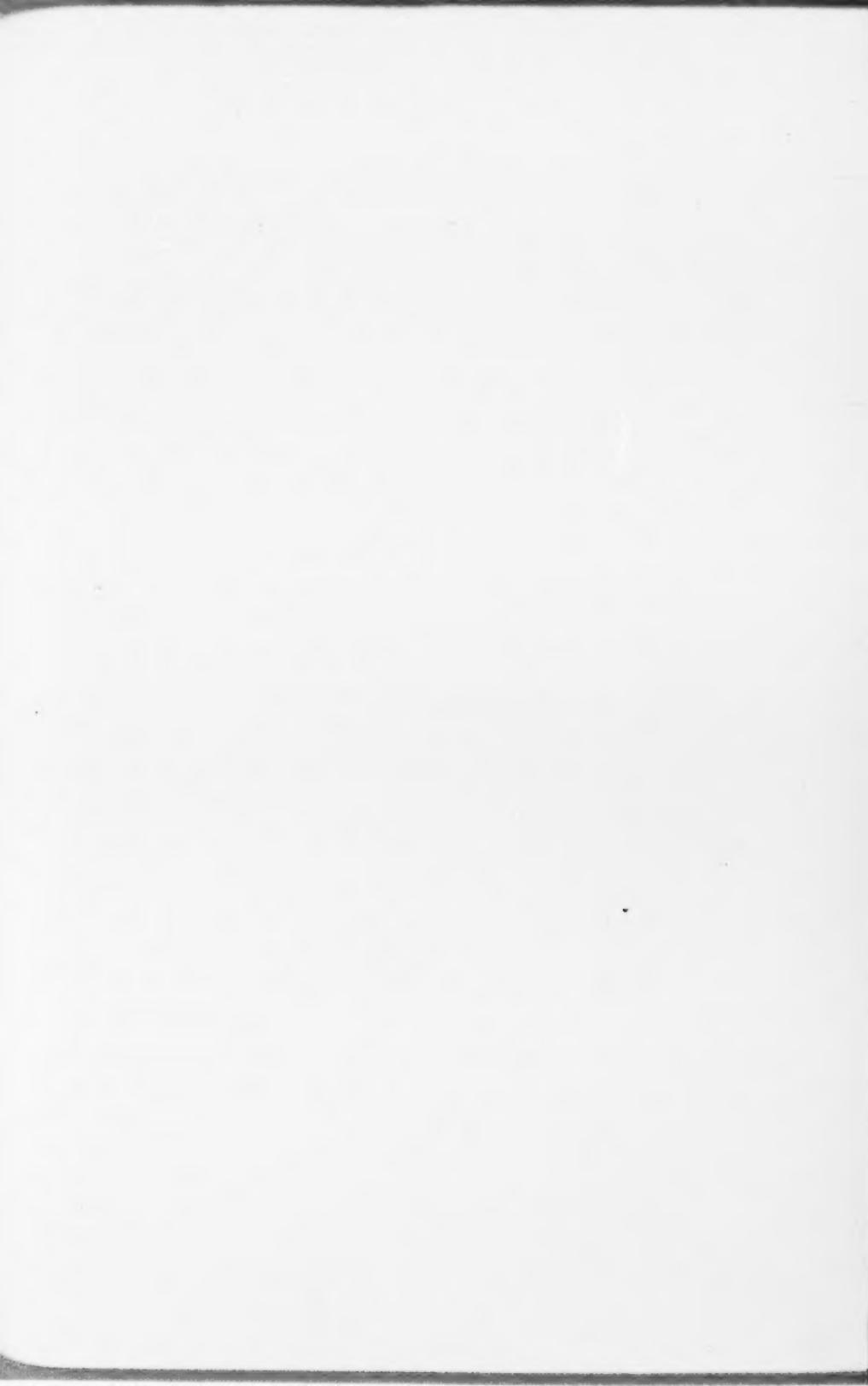
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PETITION.

Russell W. McDermott, Petitioner herein, respectfully prays to this honorable Court that a Writ of Certiorari issue to review the Decree of the United States Circuit Court of Appeals entered in the above entitled cause on November 11, 1942 (R. 259) affirming an Order and Judgment of the District Court of the United States for the Southern District of Indiana (R. 226).

The opinion of the Circuit Court of Appeals appears in the record at pages 252-8. The District Court rendered no opinion.

Petition for Rehearing and supporting brief were filed in the United States Circuit Court of Appeals for the Seventh Circuit, which petition was so filed on the 20th day of November, 1942 (R. 261-6), and overruled by said Circuit Court of Appeals without opinion on the 8th day of December, 1942 (R. 270).

Summary of the Matter Involved.

Summarily stated the petition involves the following matters:

1. The constitutional validity of Sections 7 and 8 (a) of the Securities Exchange Act of 1934 as amended, 48 Stat. 886-889, 15 U. S. C. A. #78 (g), (h) attempting to delegate to the Board of Governors of the Securities and Exchange Commission authority to promulgate rules and regulations and amend, revise and supplement the same from time to time and attempting to make violations of such rules and regulations criminal offenses, and also paragraph 78 ff (a) prescribing penalties.
2. The force, effect and validity of Regulation T adopted by the Board of Governors of the Federal Reserve System pursuant to the above act.
3. The effect of the holding of the Circuit Court of Appeals that there was substantial evidence warranting the submission of the case to the jury on Count 12 of the indictment where such holding was predicated clearly and without contradiction upon an oversight of the court to credit account in the name of James Allio with two items aggregating \$18,711.12, which credits if considered by the court would have left in the account a surplus over and above the amount of security required by the rules of the Board of Governors of the Federal Reserve System.
4. The effect of the holding of the Circuit Court of Appeals that there was substantial evidence of the misappropriation of United States Treasury bond 31022B in

the face amount of \$10,000 where the uncontradicted evidence of the witnesses produced by the government and supported by the evidence of witnesses produced by the defendant showed that there was no such misappropriation, but that the proceeds of said bond were properly applied on the account for which it was held as shown by the oral testimony of the government's witnesses and the written exhibits introduced in evidence by the government.

5. The effect of the holding of the Circuit Court of Appeals that there was sufficient evidence to warrant the submission to the jury, the question of the misappropriation of United States Treasury bond 1199K of the par value of \$5,000 in the face of the oral testimony of the owner of said bond produced as a witness for the government and her written receipt introduced in evidence by the government showing that there was no misappropriation of such bond, and that the proceeds thereof were properly and fully and honestly turned over to her.

Basis Upon Which It Is Contended That This Court Has Jurisdiction to Review the Judgment or Decree in Question.

It is contended that this court has jurisdiction to review the judgment or decree in question for each of the following reasons:

1. The Circuit Court of Appeals in this case has decided the validity of important provisions of the Securities Exchange Act of 1934 as amended including its penalty provisions and the force and effect of the rules and regulations, and particularly Regulation T of the Board of Governors of the Federal Reserve System, all of which is an important question of federal law which has not been, but should be, decided by this court.

2. An injustice has been done the petitioner which deprives him of his liberty, through an oversight or omission

of the Circuit Court of Appeals to credit the account in question with a substantial sum, towit, \$18,711.12 and in the absence of which oversight the evidence would conclusively show that there was no violation of the Securities and Exchange Act referred to, or the regulations promulgated by the Board of Governors of the Federal Reserve System thereunder, as charged in either of the counts of the indictment numbered 10 to 14 inclusive.

3. An injustice has been done the petitioner which deprives him of his liberty in holding that there was a misappropriation of United States Treasury bond 31022B in the face amount of \$10,000 and bond No. 1199K in the face amount of \$5,000 where the uncontradicted evidence of the witnesses produced by the government including the evidence of the owner of said bonds, and written documents introduced in evidence by the government showed that there was no such misappropriation, and in the absence of which there was no evidence to support counts 1 to 9 inclusive of the indictment.

The Questions Presented.

The questions presented hereunder are as follows:

1. The validity of the portions of the Securities Exchange Act of 1934 and amendments including its punitive provisions as hereinabove referred to and the force and effect of the regulations of the Board of Governors of the Federal Reserve Board made pursuant thereto and particularly Regulation T and the amendments of said Regulation T.

2. The force and effect of a decision by the Circuit Court of Appeals which is based upon an error or oversight of the court to consider a substantial credit vital to the question of the sufficiency of the evidence to sustain the verdict and judgment on counts 10 to 14 inclusive of the indictment.

3. The evidence as shown by the record in relation to the misappropriation of the bonds above mentioned in this petition and the holding of the Circuit Court of Appeals in relation thereto.

Reasons for Allowing the Writ.

The Writ of Certiorari should be granted in this case for the following reasons:

1. The Circuit Court of Appeals has decided, and we believe erroneously decided, the question of the validity of the Securities Exchange Act of 1934 and amendments or certain provisions including the punitive provisions thereof, which is an important federal law which has never been decided by this court and should be decided by this court. So also should this court decide the force and effect of the regulations adopted by the Federal Reserve Board pursuant thereto, and particularly Regulation T, to the end that persons engaged in the brokerage business may be informed of the force and effect of such regulations.

2. Where life or liberty is involved, the discretion of this court should be exercised in a case wherein the evidence in the record shows that there is no substantial evidence to support the judgment of the Circuit Court of Appeals. In the case at bar when mathematical errors or inadvertent omission of credits are eliminated, there is no evidence in the record to support a conviction under either of the counts of the indictment numbers 10 to 14 inclusive, and under the clear and unmistakable evidence produced by the government and corroborated by the evidence produced by the defendant, there was no misappropriation or conversion of either of the government bonds mentioned in the opinion of the Circuit Court of Appeals numbered 31022B in the face amount of \$10,000 and 1199K in the face amount of \$5,000 nor of any other money, property or right of any other person, and not sufficient evi-

dence to sustain a conviction under either of the counts of the indictment numbered 1 to 9 inclusive.

Substantial justice has not been done in this case. The liberty of the petitioner is involved. A supporting brief accompanies this petition in which the points above mentioned will be more fully discussed and need not receive further comment here.

WHEREFORE your petitioner respectfully prays that a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit be issued in this case to the end that the cause may be reviewed and determined by this court, and the judgment of the Circuit Court of Appeals be reversed and that petitioner be granted such other and further relief as may seem proper.

EBEN LESH,

Attorney for Petitioner.

JOSEPH H. LESH,

JULIUS C. TRAVIS,

Of Counsel.

BRIEF.

The Constitutional Validity of Certain Sections of the Securities Exchange Act of 1934 as Amended and the Force and Effect of the Rules and Regulations Adopted by the Board of Governors of the Securities and Exchange Commission.

The defendant, by his demurrer to the Counts above indicated, attacks each of said Counts on the grounds that the attempted delegation by Congress of power to the Board of Governors of the Federal Reserve System to define criminal offenses is beyond the power of Congress, and is in contravention of the Fifth and Sixth Amendments to the Constitution of the United States, and because the statute, aside from the Regulations, is indefinite and does not define any offense with sufficient certainty, and also because neither of said indicated Counts state facts sufficient to constitute a public offense. (R. 35.)

Each of the above indicated Counts of the indictment alleges that the Board of Governors of the Federal Reserve System, acting "pursuant to and in accordance with Sections 7 and 8 (a) of the Securities Exchange Act of 1934, as amended, for the purpose of preventing the excessive use of credits for the purchase and carrying of securities, did duly prescribe rules and regulations, and from time to time did duly amend, revise, and supplement such rules and regulations, said rules and regulations as so prescribed, amended, revised and supplemented being commonly known and designated as Regulation T.

If the acts charged are unlawful, it is solely because they are in contravention of Regulation T, since no such acts are prohibited by the statute.

The indictment refers to Sections 7 and 8 (a) of the Act.

These are respectively Sections 78 (g) and 78 (h), Title 15, U. S. C. A.

The question we raise is this: "Is that part of the Act which attempts to delegate to the Board of Governors the power to define criminal offenses valid?" We believe that it is not valid. We have found no reported case dealing with this phase of the Securities Exchange Act, but we believe that the principles stated in the case of *United States v. Cohen Grocery Company*, 255 U. S. 81 and *United States v. Eaton*, 144 U. S. 577, are decisive. Limitations of space forbid quotations from these authorities but we believe that under the principles stated the attempted delegation of power is void. We further call attention to the fact that the indictment does not charge that the rule or regulation T of the Board of Governors was ever promulgated, nor does it charge that the Defendant had knowledge of such rule or regulation. Regardless of who has the burden of proof of knowledge of the Regulation, it would seem that an indictment which would justify a prison sentence would have to charge that the Defendant had knowledge of the Regulation, and failing so to do the indictment would be insufficient as against a demurrer, and the demurrer to Counts 10 to 14, inclusive, should have been sustained for this reason as well as other reasons above stated.

That this attack upon the Regulations of this character is within itself sufficient ground for certiorari is held by this Court in the case of *International Railway Company v. Davidson*, 257 U. S. 506, 66 L. ed. 341.

The Holding of the Circuit Court of Appeals That There Was Substantial Evidence Warranting the Submission of the Case to the Jury on Counts 10 to 14 Inclusive, of the Indictment and Particularly Count 12 Thereof.

The opinion of the Circuit Court of Appeals in holding that there was sufficient evidence to warrant the submission of the case to the jury on Count 12 of the indictment is based on the following calculation as set out in the opinion.

“The evidence further disclosed that from October 1, 1938 to May 26, 1939, the Allio account was a general margin account, and that on March 31, 1939, there had been purchased and were in the Allio account securities having a value of \$29,679 and that the debit balance was \$24,464.16. On that day a check for \$8,000 was issued to Allio, leaving him owing \$32,464.16, against the cost of securities valued at \$26,679. On April 1 there was sold in the account 600 shares of stock for \$12,778.23, which left the account owing \$19,685.93 and securities in the account having a total market value of \$9,400. That same day there was purchased in the account 300 shares of Montgomery Ward & Co. preferred stock for \$13,926, payment for which was not made except by the sale of the 300 shares of Montgomery Ward & Co. stock on April 5, 1939. Deducting the \$9,400 value from the debit balance of \$19,685.93 left a deficiency in the account, before the purchase of the Montgomery Ward stock, of \$10,285.93.”

This computation of the Court is based upon an error or oversight of the Court to take into account certain vital factors, including a deposit of \$8,000 to the account of Allio to the firm (Govt's. Exhibit 11 K) and also a credit in the sum of \$11,211.12 for the protection of the account in the form of United States Treasury Bond #31022B in the face amount of \$10,000 but of the actual cash value of \$11,211.12 making a net error in the computation used by the Court as shown by the record in the sum of \$18,711.12

leaving in the account an amount over and above that required by the regulation of the Board of Governors.

The opinion states that during this period "a check for \$8,000 was issued to Allio, leaving him owing \$32,484.16", whereas the check was in fact \$8,500 (Government's Exhibit 11-K) but the opinion and judgment fails to show that on the same day a check for \$8,000 was issued from Allio to the firm (Government's Exhibit 11-K), which would make a net error in the opinion of the Court in the sum of \$7,500 as an increased equity in the account on this item over and above that shown in the opinion.

The opinion also fails to take into consideration that at the time of this transaction there was the United States Government bond in the face amount of \$10,000 but of the actual value of \$11,211.12, for the protection of the account making an additional error in the computation of the equity in the account at said time in said amount of \$11,211.12. This is the bond that is described under the next succeeding title of this brief and the receipts and documents therein copied and referred to.

The total error of said computation is therefore the sum of \$7,500 plus \$11,211.12, or a total error of \$18,711.12, which not only wipes out all of the deficiency but leaves in the account the amount of security required by the rules of the Board.

That we are analyzing the account correctly may be verified in a summary way by the testimony of Government's witness, Holland, who certainly did not manifest any friendliness to the Defendant, but when confronted by actual facts and figures, testified as follows:

"Q. Now you talked about this account being 'under water' (a term used by the witness as meaning under-margined) constantly, and I think you said at one time it got up to a point where it was eight thousand dollars under water, did you not?

A. I think I said a maximum of eighty-five hundred.

Q. Eighty-five hundred dollars. Now, assuming that this ten thousand dollar bond, 31022B, that was subsequently sold for in excess of eleven thousand dollars, had been in the Indianapolis guaranteeing that account, from October until April 8th, when it was sold, that condition about the account being 'under water' would not have existed? Isn't that correct?

A. That is true." (R. 89.)

Holding of the Circuit Court of Appeals That There Was Substantial Evidence of the Misappropriation of U. S. Treasury Bond 31022B in the Face Amount of \$10,000.

The opinion and judgment of the Circuit Court of Appeals holds that there was a misappropriation of \$11,211.12 the proceeds of the sale of U. S. Treasury Bond 31022B to Josephthal & Company and its application to the account carried in the name of James Allio. The evidence showed that with the knowledge and consent and at the request of Marie Langen Sweeney, the owner of the above mentioned bond, a trading account was opened for her in the name of James Allio and that in October, 1938 Government Bond 31022B in the face amount of \$10,000 was left by her with the firm of Moore, McLean & McDermott for the use and protection of the account and it was to the liquidation of this account to which said bond was applied as will appear from the following evidence which is not in any way contradicted in the record.

The evidence shows clearly that this bond was acquired by the Defendant, not on April 7, 1939, as stated in the opinion, but in October, 1938, and for the specific purpose to which it was applied at the time of sale, and to support this assertion we refer to the following:

A. The written receipt for the bond signed by Mr. McDermott and given to Mrs. Sweeney is in evidence as Gov-

ernment's Exhibit 518 and Defendant's Exhibit 2, and reads as follows:

"October, 1938. Mrs. Marie Langen Sweeney. Received \$10,000 Tr 3½-46-44 to be held and used by Mr. McDermott for collateral purposes in account known as Jas Allio or other he may see fit for trading purposes. This bond to be held in Mr. McDermott's possession and not sold until ordered by me unless otherwise it becomes necessary to do so because of market conditions. Understood Richardson McVey auditors will make up audit periodically as see fit to do so. R. McDermott." (Government's Ex. 518, Defendant's Ex. 2.)

B. Concurrently with the giving of said receipt Mrs. Sweeney gave to the Defendant written authorization relating thereto over her signature which appears in evidence as Defendant's Exhibit 3, reading as follows:

"October, 1938. R. D. McDermott, 40 N. Penn, Indpl. This is giving you authority to use the 10 M Tr Bond for trading purposes as you may see fit. Satisfactory to use Jas Allio or others you may suggest. Also agreed to notify Richardson McVey C. P. A. when activities start and audit be made periodically. Marie Langen Sweeney." (Defendant's Ex. 3.)

C. Mrs. Sweeney in her testimony states as follows: "I don't know whether the receipt mentioned James Allio or not," and after refreshing her recollection from the receipt she further testified: "I know James Allio was mentioned afterwards but I don't recall whether it was mentioned at that time or not." (R. 112, 113.)

The witness Richardson testified that he made an audit of the accounts carried in the names of K. K. Kado, James Allio, Philip Allio, and Russell Faux, and that he furnished a copy of the audit to Mrs. Sweeney and that he later discussed the audit with Mrs. Sweeney. (R. 171.) He then testified as follows:

"At the time I wrote the transmittal letter I knew

these accounts belonged to Mrs. Sweeney. I learned that from Mr. McDermott and had it confirmed by Mrs. Sweeney over the telephone." (R. 172.)

It therefore appears clear that the application of the bond herein described or its proceeds to the James Allio account was strictly in conformity to the purpose for which it was held and did not and could not constitute a misappropriation of the bond or its proceeds.

The Holding of the Circuit Court of Appeals That There Was a Misappropriation of United States Treasury Bond 1199K in the Face Value of \$5,000.

United States Treasury Bond 1199K belonging to Marie Langen Sweeney of the actual value of \$5,595.28 was sold by the petitioner Russell W. McDermott and with the knowledge and consent of the owner Marie Langen Sweeney, and for the reason hereinafter stated, the proceeds were temporarily deposited to the account of Cecelia McDermott, the wife of Russell W. McDermott, where the proceeds remained for a brief period of time. After the reason for this temporary deposit to the account of Cecelia McDermott had passed, the proceeds were reinvested in Government bonds of the identical type and same amount as the bonds sold and these substituted bonds were turned over promptly to the owner Marie Langen Sweeney.

The undisputed evidence upon this subject as shown by the testimony of Mrs. Sweeney, the owner of the bond, was as follows:

"There was some discussion with Mr. McDermott that day about making some investment in Christ Church bonds. The talk was that the Church bonds would be bought under par and were paying a better rate of interest than the government bonds. McDermott advised me that \$4,000 of government bonds would buy \$5,000 worth of Church bonds and he recommended this. No decision was reached that day.

Something was said about some of my bonds being put in Cecelia McDermott's account.

Q. Was it your suggestion that one of these bonds might be sold and the proceeds kept available to determine whether or not you should purchase these Church bonds?

A. It wasn't my suggestion. It was Mr. McDermott's suggestion. He asked if it would be all right to do it.

Q. Was that agreed to between you and him?

A. Yes, sir." (R. 118.)

She further testified upon this subject as follows:

"For a period then I didn't talk much to Mr. McDermott as he was in Chicago on account of his father's illness. When I couldn't make up my mind what I wanted to do with the bond in Cecelia McDermott's account I said I wished him to purchase a government bond, instead of the Christ Chuch bonds, and he bought government bonds with it and turned them over to me. That was some time in June, the first time I had been to his office." (R. 119.)

The receipt of Mrs. Sweeney for the substituted bonds was as follows:

".....1939: 'Received from Mrs. McDermott the following Treasury 3½s: 81874D, 4472B, 4473C, 4474D, and 4475E.'

The Court: Does that show where they came from?

The Witness: It says on this receipt: 'These to replace the \$5,000 bond sold in Cecelia McDermott's account per my instruction Good Friday.' Signed, 'Marie Langen Sweeney.' " (R. 174.)

Conclusion.

To conform to the rules of this Court requiring brevity we have not amplified upon the points involved but it is sufficient to say that there is much supporting evidence and no conflicting evidence in the record upon these questions and we believe that where the liberty of a citizen of the

United States is involved and the validity of a United States public statute and the force and effect of the regulations of a Federal Board are in question a writ of certiorari should issue and for which we shall ever pray.

Respectfully submitted,

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